

Internal Revenue Service
District Director

Department of the Treasury

Post Office Box 1680, GPO
Brooklyn, NY 11202

Date: MAR 11 1994

Person to Contact:

Contact Telephone Number:

Refer Reply to:

Employer Identification Number:

CERTIFIED MAIL

Dear Applicant:

We have considered your application for tax-exempt status under section 501(c)(3) of the Internal Revenue Code.

The evidence presented disclosed that you were incorporated under the Not-for-Profit Corporation Law of the State of [REDACTED].

The purpose for which the corporation was formed is as follows; To promote the teaching, the performing and the appreciation of the art of ballet and to exercise all powers necessary or convenient to effect any or all of the purposes for which the corporation is organized.

Your activities consist of receiving donations and the raising of funds for dance scholarships, based on merit or need, for serious dance students. The funds-raising activities consist of the following: An annual Rummage Sale and Bake Sale are held each fall; entertainment books, T-shirts, sweatshirts, tote bags, mugs, note cards, cookbooks, coffee, candy and soda are sold during the year; and advertisement in the Spring Performance Booklet is sold in addition to photographs.

The organization is administered by a volunteer Board of Directors. The Board of Directors of the [REDACTED] consists of [REDACTED] member, [REDACTED] of which have a total of [REDACTED] children enrolled in the [REDACTED]. The [REDACTED] does not have exemption with the Internal Revenue Service.

The annual scholarship auditions of the [REDACTED] are open to any dance student regardless of Race Religion, Gender or whether they are students of [REDACTED]. Recipients may or may not be related to members of the Board of Directors of [REDACTED]. Relatives of members are eligible for scholarship assistance, however members of the selection committee are excluded from participating in the selection process (audition) in which a relative is a candidate.

The selection Committee is appointed by the Board of Directors of [REDACTED] and consist of [REDACTED] members. They may be a member of either the Board of Directors of the [REDACTED] or the Board of Directors of [REDACTED].

Upon completion of all Auditions, the Selection Committee presents a full report to the Board of Directors of the [REDACTED]. [REDACTED] the Treasurer forwards a copy of the this report with the monies to the Treasurer of the school, where the recipient will study. In the past this has always been [REDACTED], although in the future an applicant may be allowed to study at another School of Dance.

Grants are awarded to individual dance students based on merit and/or need. Grant monies are deposited by the Treasurer of [REDACTED]. Recipients of scholarships are required to attend all classes for which a scholarship was awarded. Scholarships or grants awarded during the years [REDACTED] through [REDACTED] were as follows:

	(A)	(B)
Year	# of scholarships awarded to Student	# of Recipients who were/ are relatives of Board members of either Board
[REDACTED]	[REDACTED]	[REDACTED]

Percentage of
scholarships to
Relatives $[(B)/(A)]$

17%
21%
31%

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax of organizations organized and operated exclusively for charitable, religious, scientific or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

In order to qualify under IRC 501(c)(3), an organization must be both "organized" and "operated" exclusively for one or more purposes specified in that section. If the organization fails to meet either the organizational test or the operational test, it is not exempt. (Regs. 1.501(c)(3)-1(a)(1)). The organizational test relates to the rules for governing an organization and the purposes stated in its articles of organization. The operational test relates to the organization's activities.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that if more than an insubstantial part of an organization's activities is not in furtherance of exempt purposes, the organization will not be regarded as exempt.

In Better Business Bureau v. U.S., 326 U.S. 279 (1945), the Supreme Court stated that the presence of even a single, non-exempt purpose, if more than insubstantial in nature, will defeat exemption under Section 501(c)(3) of the Code, regardless of the manner or importance of the truly exempt purposes.

Section 1.501(c)(3)-1(d)(1)(i) of the Regulations provides, in part, that an organization is not organized or operated exclusively for one or more of the purposes mentioned in section 501(c)(3) of the Code unless it serves a public rather than a private interest. An organization may not be exempt if it is operated for the benefit of private individuals.

In the case of John Marshall Law School v. U.S.T.C. 9514 (CT. CL. 1981), the Court found that the commissioner acted properly revoking exemption under I.R.C. 501(c)(3), because a portion of the organization's net earnings inured to the benefit of the private individuals who operated the organization and their families. The inurement consisted of, but was not limited to, payments to the families as follows: 1) Unsecured, interest-free loans with no fixed repayment schedule for personal expenditures, automobiles, townhouses, etc. 2) Interest-free loan to an officer for the purchase of a home, in the officer's name, which was taken as a business expense on the books of the organization. 3) Scholarships to children of full time faculty members where the scholarships were only given to the children of officers.

In Charleston Chair Company, Plaintiff v. United States of America Defendant U.S. District Court, East. Dist. S.C. Charleston Div., Civil Action No. 6995, January 30, 1962, the organization was denied exemption under section 501(c)(3) of the Code because it granted a substantial portion of its funds for scholarship awards to the son of a trustee of the organization. Exemption was denied on the ground that: "the making of contributions from the funds of an organization to the members of the organization, or relatives of members, is considered to be personal and private in character", and because of this it was concluded that "It cannot, therefore, be said that no part of the net earnings inures to the benefit of any private shareholders or individual."

Revenue Ruling 85-175, 1985-2 C.B. 276 state that a private foundation that awards scholarships on a preferential basis to family members and relatives of the Trust's grantor does not award such scholarships on an objective and nondiscriminatory basis. These grants do not serve a charitable purpose.

Since a substantial amount of the scholarship funds are devoted to children and relative of officers of the corporation and of the selection committee, the organization is serving a private interest and therefore, does not qualify for tax exempt status section 501(c)(3) of the Code.

Accordingly, we conclude that you do not meet the requirements for exempt status under section 501(c)(3) of the Code and propose to deny your request for exemption under that section.

You are required to file a taxable return Form 1120 or 1041 with the District Director of Internal Revenue Service. Please send the return to the Internal Revenue Service, P.O. Box 1680, General Post Office, Brooklyn, NY 11202.

Contributions made to you are not deductible by the donors as charitable contributions as defined in section 170(c) of the Code.


If you do not agree with this determination, you may request a Conference with the Regional Director of Appeals by protesting in accordance with the enclosed instructions within 30 days.

Protests submitted which do not contain all the documentation stated in the instructions will be returned for completion.

If we do not hear from you within that time this determination will be considered final and the appropriate State Officials will be notified.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides in part that "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Sincerely yours,



District Director

Enclosure: Publication 892